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LMW ELECTRONICS PTE LTD

v.

ANG CHUANG JUAY & ORS

B

HIGH COURT MALAYA, JOHOR BAHRU
VERNON ONG LAM KIAT JC
[CIVIL SUIT NO: (MT-1) 22-833-2007]
29 SEPTEMBER 2009

C ***COMPANY LAW:*** *Directors - Recovery of debt against director - Whether business of company conducted with intent to defraud creditors - Whether directors knowingly a party to carrying on of business in that manner - Companies Act 1965, s. 304(1)*

D Between 12 May 2003 to 14 November 2003 the plaintiff sold and supplied electronic components to the 5th defendant. The 5th defendant failed to pay the purchase price of the goods. On 5 March 2004 the plaintiff filed an action ('2004 Action') against the 5th defendant claiming the sum of US$90,585.01. The 5th defendant filed its defence and counter-claim for US$26,356.39. In
E 2004 all of the 5th defendant's physical assets including its stocks, plant, equipment and machinery were transferred to its holding company ('China Enersave Ltd.') in Singapore for no consideration. In 2004 the 5th defendant wrote-off all of its physical assets
F including its stocks, plant, equipment and machinery costing RM1,462,036. The 3rd and 4th defendants signed a board resolution dated 29 October 2004 authorising the 4th defendant to sign a deed of assignment for the transfer of trade receivables of US$794,000 to China Enersave Ltd for no consideration. By a Deed of Assignment
G dated 31 October 2004 ('Deed of Assignment') the 5th defendant transferred the said trade receivables to China Enersave Ltd. The 5th defendant's auditors were unable to confirm that the company's Reports And Financial Statements as at 31 December 2004 ('2004 Audited Accounts') had been properly drawn up in accordance with
H the provisions of the Companies Act 1965 ('the Act') and approved accounting standards in Malaysia so as to give a true and fair view of the state of affairs of the company as at 31 December 2004 and of the results and cash flows of the company for the financial year ended and the matters required by s. 169 of the Act. The plaintiff
I entered judgment against the 5th defendant on 4 January 2006 in

the 2004 Action after the 5th defendant abandoned its defence and counterclaim. The 1st and 2nd defendants were directors and minority shareholders of the 5th defendant. The 3rd and 4th defendants were directors of the 5th defendant and also China Enersave Ltd. The plaintiff's claim here was predicated on s. 304(1) of the Act wherein it contended that during the subsistence of the 2004 Action the 1st, 2nd, 3rd and 4th defendants, as directors and/or shareholders of the 5th defendant unlawfully dissipated the assets and funds of the 5th defendant.

Held (dismissing the claim against the 1st and 2nd defendants with costs and allowing the claim against the 3rd and 4th defendants with costs):

(1) During the period from 1 January 2003 to 31 December 2004 the business of IDSM had been carried out within the meaning of s. 304(1) of the Act. *R v. Grantham* (refd); *Re Augustus Barnett & Son Ltd* (refd); *In re Sarflax Ltd* (refd); *In re FP & CH Matthews Ltd* (refd). (para 19)

(2) The actions of the management of the 5th defendant show that they did not act *bona fide* in the interest of the company as a whole; they did not act honestly. Instead they acted for a collateral purpose. The 5th defendant was stripped of all its physical assets and its trade receivables. The ultimate beneficiary of these actions was China Enersave Ltd, the holding company. The actions were not consistent with current notions of fair trading. It was deceitful and unethical. It had been explicitly condemned by the 5th defendant's own auditor. In the circumstances the court had no hesitation in finding that the business of the 5th defendant appears to have been carried out with intent to defraud creditors within the meaning of s. 304(1). *Coleman v. The Queen* (refd); *PJTV Denson (M) Sdn. Bhd. & Ors v. Roxy (Malaysia) Sdn Bhd* (refd); *Siow Yoon Keong v. H Rosen Engineering BV* CA (refd); *In re William C Leitch Bros Ltd* (refd); *In re Patrick & Lyon Ltd* (refd); *R v. Grantham,* (refd); *In re Gerald Cooper Chemicals Ltd* (refd); *In a Company (No 01418 of 1988*) (refd); *Rahj Kamal bin Abdullah v. PP* (refd). (paras 20-26)

(3) The 1st and 2nd defendants were not party to the carrying on of the business in that manner. It was clear that throughout the period in question the management of the 5th defendant was in the control of the 3rd and 4th defendants. The 'Statement By Directors' made by the 3rd and 4th defendants in the 2004 Audited Accounts and the Statutory Declaration by the 4th defendant as the director primarily responsible for the accounting records and financial management of the 5th defendant point directly to their role in carrying out the 5th defendant's business. The ultimate beneficiary of the transfer of the trade receivables and physical assets and stocks was China Enersave Ltd. The entire business was managed and controlled by the 3rd and 4th defendants *qua* directors of the 5th defendant. They acted knowingly in the service of China Enersave Ltd. They were nominated to be directors of the 5th defendant by China Enersave Ltd to safeguard China Enersave Ltd's interests. Accordingly, the claim against the 1st and 2nd defendant was dismissed with costs and the 3rd and 4th defendants were, jointly and severally, to forthwith pay to the plaintiff the judgment debt of US$90,858.01 (or the equivalent in Ringgit Malaysia on the date of the order hereof) due and owing by the 5th defendant to the plaintiff together with interest and costs. (paras 27-28)

Case(s) referred to:

Caparo Industries plc v. Dickman & Ors [1990] 1 All ER 568 ***(refd)***
Coleman v. The Queen [1987] 5 ACLC 766 ***(refd)***
H Rosen Engineering BV v. Siow Yoon Keong [1997] 1 CLJ 137 HC ***(refd)***
In a Company (No 01418 of 1988) [1991] BCLC 198 ***(refd)***
In re FP & CH Matthews Ltd [1982] 1 All ER 338 ***(refd)***
In re Gerald Cooper Chemicals Ltd [1978] 2 All ER 49 ***(refd)***
In re Patrick & Lyon Ltd [1933] Ch 786 ***(refd)***
In re Sarflax Ltd [1979] 2 WLR 202 ***(refd)***
In re William C Leitch Bros Ltd [1932] 2 Ch 71 ***(refd)***
PJTV Denson (M) Sdn Bhd & Ors v. Roxy (Malaysia) Sdn Bhd [1980] 1 LNS 55 FC ***(refd)***
R v. Grantham [1984] 3 All ER 166 ***(refd)***
Rahj Kamal Abdullah v. PP [1998] 1 SLR 447 ***(refd)***
Re Augustus Barnett & Son Ltd [1986] BCLC 170 ***(refd)***
Re Maidstone Buildings Provisions Ltd [1971] 3 All ER 363 ***(refd)***
Siow Yoon Keong v. H Rosen Engineering BV [2003] 4 CLJ 68 CA ***(refd)***
Ting Ling Kiew & Anor v. Tang Eng Iron Works Co Ltd [1992] 3 CLJ 1685; [1992] 1 CLJ (Rep) 331 SC ***(refd)***
Winkworth v. Edward Baron Development Co Ltd & Ors [1987] 1 All ER 114 ***(refd)***

Legislation referred to:
Companies Act 1965, ss. 166A(3), (5), 169(1), (3), (14), 174(3)(a), (b), 304(1), 305

Other source(s) referred to:
Walter Woon, *Company Law,* 2nd edn, p 274

For the plaintiff - CM Yeo; M/s CM Yeo & Assoc
For the 1st & 2nd defendants - Susan Yeap; M/s The Law Chambers of Yeap & Lim
For the 3rd & 4th defendants - Russell Lua Kok Hiyong (Patricia Chan with him); M/s Lua & Mansor

Reported by Susheila Sreedharan

JUDGMENT

Vernon Ong Lam Kiat JC:

[1] On 4 January 2006 the plaintiff obtained judgment against the 5th defendant IDSM Electronics Sdn. Bhd. ('IDSM') for US$90,585.01 on a trade debt for electronic components sold and delivered by the plaintiff to IDSM. The plaintiff claims that the assets and funds of IDSM were unlawfully dissipated by the 1st, 2nd, 3rd and 4th defendants as directors and/or shareholders of IDSM. The plaintiff is seeking a declaration that the 1st, 2nd, 3rd and 4th defendants as directors of IDSM are personally liable, jointly and/or severally, to the plaintiff for the judgment debt of US$90,585.01 due and owing by IDSM to the plaintiff and other consequential orders.

The Facts

[2] The salient facts as presented by the evidence are as follows:

(1) Between 12 May 2003 to 14 November 2003 the plaintiff sold and supplied electronic components to IDSM. IDSM failed to pay the purchase price of the goods amounting to US$90,585.01. On 5 March 2004 the plaintiff filed a civil suit at the Johor Bahru High Court under Civil Suit No. 22.190.2004 ('2004 action') against IDSM claiming the sum of US$90,585.01. IDSM filed a defence and counter-claim for US$26,356.39.

(2) In 2004 all of the physical assets of IDSM including its stocks, plant, equipment and machinery were transferred to its holding company ('China Enersave Ltd.') in Singapore.

(3) In 2004 IDSM wrote-off all of its physical assets including its stocks, plant, equipment and machinery costing RM1,462,036.

(4) The 3rd and 4th defendants signed a board resolution dated 29 October 2004 authorising the 4th defendant to sign a deed of assignment for the transfer of trade receivables of US$794,000 (due to IDSM from its trade debtor Perle Systems Ltd) to China Enersave Ltd.

(5) By a deed of assignment dated 31 October 2004 ('Deed of Assignment') IDSM transferred the said trade receivables to China Enersave Ltd.

(6) IDSM's Reports And Financial Statements as at 31 December 2004 ('2004 Audited Accounts') was qualified by its auditor in the following manner:

> We would like to draw your attention to the followings *(sic)*:
>
> 1. The Company ceased operation in December, 2004 and during the financial year, the Company has significantly written off its physical and tangible assets;
>
> 2. The Company made a provision for stocks of RM2,106,859 comprising mainly raw materials which the Company has claimed to be obsolete, damaged and of little resale values;
>
> 3. Plant and equipment with net book values of RM308,189 were written off on the ground of their non-functional condition and little disposal value. Included in the written-off plant and equipment are machinery costing RM1,462.036 and accumulated depreciation of RM1,417,179 as at year's end;
>
> 4. The Company made a provision for all its debts existing at year end amounting to RM4,527,688. Certain legal actions had been taken against the trade sum of RM1,050,453; and
>
> 5. The Company's financial performance was in significant loss position for the current and previous financial years.

In view of the significance of the matters discussed in the preceding paragraphs, we are unable to form any opinion as to whether the financial statements have been properly drawn up in accordance with the provisions of the Companies Act, 1965 and approved accounting standards in Malaysia so as to give a true and fair view of:

(i) the state of affairs of the Company as at 31 December, 2004 and of the results and cash flows of the Company for the financial year ended; and

(ii) the matters required by Section 169 of the Companies Act, 1965 to be dealt with in the financial statements. (emphasis added)

(7) On 4 January 2006 the plaintiff entered judgment against IDSM for US$90,585.01 in the 2004 Action after IDSM abandoned its defence and counter-claim.

(8) The 1st and 2nd defendants are directors and shareholders of IDSM; the 1st defendant resigned as director on 1 June 2004.

(9) The 3rd and 4th defendants are directors of IDSM.

(10) The 3rd defendant is also a director of China Enersave Ltd.

(11) The 4th defendant is an executive director and shareholder of China Enersave Ltd.

(12) The holding and ultimate holding company or companies of IDSM according to IDSM' Audited Accounts (a) as at 31 December 2003 are China Enersave Ltd and ACMA Ltd; and (b) as at 31 December 2004 is China Enersave Ltd.

Plaintiff's Case

[3] The plaintiff's claim is predicated on s. 304(1) of the Companies Act 1965 ('the Act'). It is contended that during the subsistence of the 2004 Action the 1st, 2nd, 3rd and 4th defendants, as directors and/or shareholders of IDSM unlawfully dissipated the assets and funds of IDSM. Firstly, they unlawfully wrote-off all its stocks valued at RM3,229,969 as at 31 December 2003 and all its plant, equipment and machinery (costing RM1,530,115 with a book value of RM405,417 as at 31 December 2003). Secondly, they unlawfully transferred all the physical assets of

IDSM including all its stocks (inventories), plant, equipment and machinery to China Enersave Ltd., in Singapore for which China Enersave Ltd did not give any consideration. Thirdly, they unlawfully transferred and/or assigned the trade receivables of IDSM amounting to US$794,000 (due and owing from its trade debtor Perle Systems Ltd) to China Enersave Ltd; rendering China Enersave Ltd indebted to IDSM the equivalent sum of US$794,000. Fourthly, the resulting debt of US$794,000 was also wholly written-off by IDSM which resulted in China Enersave Ltd receiving the benefit of the trade receivables without any consideration whatsoever. The assignment of the trade debt was without any corporate purpose or commercial benefit to IDSM. The 3rd and 4th defendants resigned as directors of IDSM on 1 January 2006. Three days later, on 4 January 2006 IDSM abandoned its defence and counter-claim in the 2004 Action allowing the plaintiff to obtain a paper judgment against IDSM. As a consequence of the aforesaid actions IDSM was left with no assets or funds to pay the debt owed to the plaintiff by the time the judgment was obtained on 4 January 2006.

The Evidence

[4] Mr. Kuan Cheng Toon (PW2) is an audit partner of the firm which audited IDSM's 2004 Audited Accounts. PW2 qualified the 2004 Audited Accounts because he was unable to form a professional opinion as to whether the said accounts had been properly drawn up in accordance with the provisions of the Act and approved accounting standards. PW2 was unable to verify that the 2004 Audited Accounts gives a true and fair view of the affairs of IDSM. In particular, PW2 said that IDSM had written-off (i) stocks totalling RM2,106,859 claiming all stocks to be obsolete, damaged and of little resale value; and (ii) plant and equipment, other than machinery, with a net book value of RM308,189 claiming the same to be in a non-functional condition and of little disposal value and machinery costing RM1,462,036. IDSM did not allow PW2's staff or an independent valuer to inspect and verify both claims. In both instances, PW2 said that 'it is not justifiable and convincing in audit aspect to wholly write off the significant amount of the stocks to zero value without obtaining appropriate and sufficient supporting evidence and documents'. PW2 also said that IDSM had made provision to write-off the whole of its trade receivables amounting to RM4,527,688 claiming the same to be doubtful debts although

RM3,017,200 of the trade receivables due from Perle Systems Ltd were to be paid pursuant to a Debt Settlement Agreement entered on 15 September 2003; and the said RM3,017,200 was assigned to China Enersave Ltd under the Deed of Assignment. PW2 said that in view of the Debt Settlement Agreement and the Deed of Assignment the write-off of the RM3,017,200 trade receivables is unjustifiable and incorrect.

[5] The 1st defendant testified that he resigned as a managing director of IDSM on 1 June 2004 but remained as a shareholder. In 2003 IDSM was incurring losses and the board of directors decided to down-size by reducing manpower and disposing off two units of shop houses. The shareholders of IDSM also decided to shift the equipments and raw materials to Singapore. He said that the said transactions were commercial decisions by the majority of the shareholders. All the decisions made by IDSM were in fact made by China Enersave Ltd. He did not have any personal knowledge of the Deed of Assignment. Under cross-examination he said that he did not object when the plant, equipment and machinery and inventory and material were moved to China Enersave Ltd for zero consideration because he was not aware of the zero consideration. He was not aware of the assignment of the trade receivables of RM3 million to China Enersave. He denied the suggestion that as managing director of IDSM until 1 June 2004 and as shareholder he stood by and allowed IDSM's assets and funds to be dissipated to China Enersave Ltd. He admitted that he was aware that IDSM had trade debts at the material time.

[6] The 2nd defendant is a director and shareholder of the 1st defendant company. He said that back then the company secretary called him asking him to go to her office to sign a resolution; he cannot remember asking her what the resolution was about and he did not take the trouble to see the company secretary and she never called him again after that. He said that he did not have any personal knowledge of the Deed of Assignment. The 2nd defendant said that all decisions made by IDSM was in fact made by China Enersave Ltd. In cross-examination he agreed that the transfer of the RM3 million trade debt to China Enersave Ltd is wrong; he also agreed that there is no reason whatsoever for IDSM to transfer the trade receivables to China Enersave Ltd. He testified that he did not know the purpose for the assignment of the RM3 million trade receivables to China Enersave Ltd. He did not sign the

resolution. He also said that IDSM's assets were moved to China Enersave Ltd or their related company. The 2nd defendant was aware that IDSM was shutting down in 2003 because they had already sold off the factory. The 2nd defendant also admitted that he was aware that IDSM had trade debts at the material time.

[7] The 3rd defendant is a director of China Enersave Ltd. He testified that at all material times he was a director of IDSM; he was nominated as a director by China Enersave Ltd to look after its interests. He agreed that he had an indirect interest in IDSM through his share purchase option in China Enersave Ltd. He admitted signing the 2004 Audited Accounts; he also admitted signing the Deed of Assignment. The 3rd defendant agreed that China Enersave Ltd owed IDSM RM531,820 as at 31 December 2003. Under cross-examination he disagreed with the suggestion that there is no reason for the said assignment. However, he agreed that there were no reasons given for the assignment. The 3rd defendant was unable to confirm whether all the plant, equipment and machinery, inventory and raw materials were moved to China Enersave Ltd. He also said that China Enersave Ltd divested its majority shares in IDSM on 28 October 2004 so that as at 31 December 2004 China Enersave Ltd did not hold any shares in IDSM. However, he agreed that according to the 2004 Audited Accounts China Enersave Ltd is still regarded as a holding company. One day after China Enersave Ltd announced its divestment of its shares IDSM passed a resolution to assign the RM3 million trade receivables to China Enersave Ltd. The Deed of Assignment for the trade receivables was signed three days after that. The 3rd defendant admitted that the resolution for the assignment of the trade receivables and the Deed of Assignment was not disclosed in the 2004 audited accounts of China Enersave Ltd. He agreed that he and the 4th defendant authorised the Deed of Assignment but denied authorising writing-off the plant, equipment, machinery, inventory and raw materials. He also agreed that both he and the 4th defendant were the management of IDSM at that time. Even though China Enersave Ltd no longer held shares in IDSM the 3rd defendant remained as a director until 1 January 2006.

[8] The 4th defendant testified that he is the executive director of China Enersave Ltd and that he was appointed as a director of IDSM as China Enersave Ltd's corporate representative. He

confirmed that he is a shareholder of China Enersave Ltd. He said that the 2004 Audited Accounts stating the China Enersave Ltd is its holding company is not true. He also disagreed with the suggestion that this representation was so that China Enersave Ltd could avoid disclosing and explaining the subsequent transfer of ISDM Electronics' funds and substantial assets (which have been written-off) to China Enersave Ltd. The 4th defendant said that he was involved in the key decision making process of the board of directors of IDSM at all material times; but he denied being involved in the management. He admitted signing the resolution and Deed of Assignment. He denied the suggestion that there is no corporate purpose for the transfer of funds. He also claimed to have no personal knowledge of the transfer of the plant, equipment, machinery, inventories and raw materials to China Enersave Ltd.

[9] Mr. Koo Ah Seang (DW5) the chief executive officer of China Enersave Ltd denied that any of the IDSM' directors had ever traded with intent to defraud the plaintiff. He said that at the material time IDSM was still solvent.

1st And 2nd Defendants' Defence

[10] The 2nd defendant did not sign the resolution on 29 October 2004 authorising the Deed of Assignment of the trade debt of RM3 million because he was not informed of it. On that date the 1st defendant was no longer a director and he had no knowledge of the matter. The 2nd defendant only became aware of this transaction after the 2004 Action had been instituted.

[11] There was nothing to show that there is any intent to defraud or any fraudulent purpose. The 1st and 2nd defendant denied any involvement in the Deed of Assignment; the 1st defendant had resigned as a director prior to the date of the execution of the Deed of Assignment and the 2nd defendant was not made aware of the existence of the same.

[12] As minority shareholders the 1st and 2nd defendants are not the decision makers in IDSM. The decision to remove IDSM's plant, equipment, machinery, inventories and raw materials to China Enersave Ltd in Singapore was made by the majority shareholder and not by the minority shareholders. Even if they had objected to it, the majority will prevail. At any rate both the 1st and 2nd defendant denied any knowledge of the same.

[13] The down-sizing of IDSM was morally acceptable by the commercial world as a way to salvage a company which was suffering from huge losses and the 1st and 2nd defendants did not make any personal gains from it (*H. Rosen Engineering B. V v. Siow Yoon Keong* [1997] 1 CLJ 137; *Ting Ling Kiew & Anor v. Tang Eng Iron Works Co. Ltd.* [1992] 3 CLJ 1685; [1992] 1 CLJ (Rep) 331). From the evidence tendered in court the 1st and 2nd defendants did not have the fraudulent intent and neither did they carry out any fraudulent act.

3rd And 4th Defendants' Defence

[14] Learned counsel submitted that the plaintiff's claim should have been brought under s. 305 of the Act for misfeasance or breach of trust or duty as directors of IDSM. In an action under s. 304 of the Act the plaintiff must establish that "a person must have taken positive steps; merely inertia was not enough" in the fraudulent trading (*Re Maidstone Buildings Provisions Ltd* [1971] 3 All ER 363). There was no evidence to show that the 3rd and 4th defendants were involved in the trading or running of business of IDSM. IDSM was not bound to pay off every debt as soon as it is incurred. When the plaintiff filed a suit against IDSM in 2004 the suit was properly defended (*Winkworth v. Edward Baron Development Co. Ltd. & Ors* [1987] 1 All ER 114). The mere fact that IDSM's solicitors did not appear in case management does not mean that they filed a sham defence and counter-claim. In 2003 when IDSM was trading with the plaintiff IDSM was solvent. The directors only owe duties to creditors when the company is insolvent. When a company is solvent the directors owe its duties to the shareholders of the company.

[15] It was also contended that PW3 did not meet up with the directors or former director of IDSM before qualifying the financial statements. There is no evidence to show that IDSM when carrying out the normal corporate exercise to cut losses by selling assets, reducing workers in 2004 before the judgment was entered in 2006 can be said to have intended to defraud toe plaintiff. The decision of a company to cut losses and carry out any corporate exercise to prolong its survival are matters to be decided by the board of directors and not by the court (*Company Law*, 2nd edn Walter Woon at p 274). The decision to down-size, cut losses, etc by

IDSM in 2004 was based on the poor performance of IDSM and the decision of China Enersave Ltd to sell its shares in good faith; all of which are within the discretion of the management.

[16] Finally it was submitted that since the 3rd and 4th defendants are nominee directors there is no basis for the plaintiff to claim against them for fraudulent trading. They were not knowingly party to the business conducted in 2003. The 2nd defendant admitted the 3rd and 4th defendants did not know about IDSM's IPO office in Singapore. Therefore they did not have any knowledge of the 44 deliveries made by the plaintiff to IDSM's Singapore office in 2003. Without any personal knowledge they cannot be held liable for the trade debt of IDSM. Section 304 of the Act requires that the person concerned should be a party to the carrying on of the business in fraudulent manner (*Re Maidstone Buildings Provisions Ltd, supra*).

Findings Of The Court

[17] The plaintiff's claim is predicated on s. 304 of the Act. Section 304(1) provides as that:

> If in the course of the winding-up of a company or in any proceedings against a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company may if it thinks proper so to do declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all of any of the debts or other liabilities of the company as the Court directs.

[18] The issue before the court falls upon the interpretation of s. 304(1) and whether the facts of this case falls within the meaning of that subsection. The wording of the section is quite clear. It is only necessary to establish that there was an intention to defraud. The standard of proof required is a lower degree of proof by reason of the words 'if it appears' in s. 304(1). It is therefore sufficient if on the evidence before the court it appears that the business of IDSM has been conducted with intent to defraud creditors or for any other fraudulent purpose.

A

First Issue

[19] The first issue to be determined is whether IDSM carried out business within the meaning of s. 304(1). The words 'any business of the company has been carried out ...' has been interpreted in a
B number of cases to include (i) in a criminal case, the obtaining of credit for the company (*R v. Grantham* [1984] 3 All ER 166); (ii) providing letters of comfort to a subsidiary even though on the facts if that case was held not to be fraudulent (*Re Augustus Barnett & Son Ltd* [1986] BCLC 170); (iii) the collection of assets acquired in
C the course of business and distribution of proceeds thereof in payment of debts (*In re Sarflax Ltd* [1979] 2 WLR 202); and payment of two cheques into the company current account with the bank thereby clearing the company's overdraft (*In re FP & CH Matthews Ltd* [1982] 1 All ER 338). The said words have been
D interpreted to include a myriad of activities and transactions undertaken by a company. In 2003 IDSM purchased electronic components from the plaintiff. IDSM's defence in the 2004 Action is premised on the ground the electronic components were purchased from the plaintiff. It was only contended that the
E electronic components were defective and not of merchantable quality. IDSM's 2003 Audited Accounts showed an income revenue of RM6,860,094. However, as stated in the auditor's report to the 2004 Audited Accounts IDSM ceased operation in December 2004. On these facts, the court finds that during the period from
F 1 January 2003 to 31 December 2004 the business of IDSM has been carried out.

Second Issue

[20] The second issue to be determined is whether the business of
G IDSM has been carried on 'with intent to defraud creditors ... or for any fraudulent purpose' within the meaning of s. 304(1)? What is an intent to defraud? It is an intent to deprive creditors, or some creditors, of an economic advantage or inflict upon them some economic loss (*Coleman v. The Queen* [1987] 5 ACLC 766). What
H is fraud? The existence of fraud is a question of fact. It is dependent upon the circumstances of each particular case as stated by the Federal Court in *PJTV Denson (M) Sdn Bhd & Ors v. Roxy (Malaysia) Sdn Bhd* [1980] 1 LNS 55. Raja Azlan Shah CJ (Malaya) (as HRH then was) said:

I

> Whether fraud exists is a question of fact, to be decided upon the circumstances of each particular case. Decided cases are only illustrative of fraud. Fraud must mean "actual fraud, ie, dishonesty of some sort" for which the registered proprietor is a party or privy. "Fraud is the same in all courts, but such expressions as 'constructive fraud' are ... inaccurate;" but "'fraud' ... implies a wilful act, on the part of one, whereby another is sought to be deprived, by unjustifiable means, of which he is entitled." (per Romilly MR in *Green v. Nixon*). Thus in *Waimiha Sawmilling Co. Ltd v. Waione Timber Co. Ltd.* it was said that "if the designed object of a transfer be to cheat a man of a known existing right, that is fraudulent ..."

[21] The words 'with intent to defraud creditors ... or for any fraudulent purpose' of s. 304(1) should be read disjunctively even though on the facts of the case both limbs are relevant and applicable (*Siow Yoon Keong v. H Rosen Engineering BV* [2003] 4 CLJ 68 CA). The said words has been interpreted in a number of cases to include (i) a situation where a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts (*In re William C Leitch Bros Ltd* [1932] 2 Ch 71); (ii) that fraud in the context of fraudulent trading constitutes 'actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame' (*In re Patrick & Lyon Ltd* [1933] Ch 786 at p 790); (iii) where a person who takes part in the management of a company's affairs obtains credit or further credit for the company when he knows that there is no reason for thinking that funds will become available to pay the debts when it becomes due or shortly thereafter *(R v. Grantham, supra)*; (iv) where a company accepted the purchase price in advance knowing that it would not supply the goods and would not repay the advance paid *(In re Gerald Cooper Chemicals Ltd, supra)*; and (v) a person was knowingly party to the business of a company having been carried out with intent to defraud creditors if at the time when debts were incurred by the company he had no good reason for thinking that funds would be available to pay those debts when they became due or shortly thereafter and there was dishonesty involving real moral blame according to current notions of fair trading (*In a Company (No 01418 of 1988)* [1991] BCLC 198). Notwithstanding the word 'creditors' in s. 304(1), for the purpose of s. 304(1) it does not matter that only one creditor was defrauded

and that he was defrauded by one transaction, provided that the transaction could properly be described as a fraud on a creditor perpetuated in the course of carrying on business (*Siow Yoon Keong v. H Rosen Engineering BV, supra*; *In re Gerald Cooper Chemicals Ltd* [1978] 2 All ER 49). Whether there was any intention on the part of the defendants to defraud or to carry out any fraudulent purpose is a question of fact to be inferred from the surrounding circumstances and the subsequent conduct of the defendants, especially the concealment of material facts (*Rahj Kamal bin Abdullah v. PP* [1998] 1 SLR 447).

[22] In 2003 IDSM purchased and took delivery of electronic components from the plaintiff. IDSM did not pay for the same resulting in the plaintiff instituting legal action against IDSM for US$90,585.01 in the 2004 Action. IDSM contended that the electronic components were defective and not of merchantable quality and counter-claimed for damages. However, in 2006 IDSM abandoned its defence and counter-claim whereupon the plaintiff obtained judgment against IDSM on its claim. In this connection it is important to trace the following events which took place in 2003 and 2004:

(1) In 2003 IDSM was suffering losses. IDSM was down-sizing. IDSM had sold off two units of shop houses and cut down on manpower;

(2) In 2004 all of IDSM' physical assets (plant, equipment, machinery, stocks and raw materials) were shifted to China Enersave Ltd. No consideration was given by China Enersave Ltd to IDSM for the physical assets.

(3) In 2004 IDSM transferred its trade receivables of RM3,017,200 to China Enersave Ltd for no consideration.

(4) In 2004 IDSM wrote-off (a) stocks of RM2,106,859 comprising of raw materials worth RM1,948,771; (b) plant and equipment worth RM308,189.99 and machinery worth RM1,462.036; and (c) trade receivables amounting to RM4,527,688.

(5) IDSM ceased operations in December 2004.

[23] The aforesaid events when examined in the light of the auditor's comments and evidence are particularly significant. IDSM's auditor (PW3) was unable to confirm that the 2004 Audited Accounts had been properly drawn up in accordance with

the provisions of the Act and approved accounting standards in Malaysia. PW3 was also unable to verify that the 2004 Audited Accounts gives a true and fair view of the state of affairs of IDSM as at 31 December 2004 and of the results and cash flows of IDSM and of the matters required under s. 169 of the Act. PW3 explained that (i) the writing-off of the RM2,106,859 worth of stocks is not justifiable and convincing in the absence of proper and sufficient supporting evidence and documents; and (ii) the writing-off of the plant, equipment (RM308,189) and machinery (RM1,462,036) is unjustifiable and not convincing because the plant, equipment and machinery were still able to produce goods to generate a revenue of more than RM6 million in 2003 and RM230,000 in 2004. In both cases IDSM did not allow the auditor or an independent valuer to inspect and verify the claims. Equally significant are PW3's comments on the writing-off of IDSM's trade receivables of RM4,527,688 as doubtful debts. PW3 explained that this provision to write-off RM4,527,688 is also questionable, unjustifiable and incorrect because RM3,017,200 of the trade receivables from Perle Systems Ltd were to be paid under a Debt Settlement Agreement dated 15 September 2003 but it had been transferred to China Enersave Ltd under the Deed of Assignment.

[24] Under subsections (1) & (3) of s. 169 of the Act the directors of a company are under a duty to lay before the company in general meeting a profit and loss accounts and a balance sheet which have been duly audited. The directors are obliged by law to ensure that the accounts of the company are made up in accordance with approved accounting standards (s. 166A(3)). In this case the auditor has categorically stated that the accounts have not been properly drawn up in accordance with the provisions of the Act and approved accounting standards in Malaysia. It implies that the profit and loss accounts does not give a true and fair view of the profit and loss of IDSM. In such an event it is the duty of IDSM's directors to (i) disclose by way of a note on the accounts their reason for not making the accounts in accordance with the approved accounting standards and (ii) give particulars in the notes of the quantified financial effect on the accounts if the relevant accounting standards was complied with (s. 166A(5)). On this issue the court finds that there is dereliction of duty on the part of IDSM's directors as there is nothing in the notes to the accounts explaining why the profit and loss accounts was not made out in accordance with approved accounting standards. The auditor was also unable to verify that the

2004 Audited Accounts gives a true and fair view of the state of affairs of IDSM. This further implies that the balance sheet does not give a true and fair view of the state of affairs of the company (s. 169(14) of the Act).

[25] These aforesaid comments coming from IDSM's own auditors are very telling. It is an indictment against the management of IDSM. It is the statutory duty of the auditor to examine the accounting records and other records and registers kept by IDSM as required under the Act and to form an opinion as to whether the auditor has obtained all the information and explanations that are required (s. 174(3)(a) & (b)). It is pertinent to note that the auditor is duty bound to be independent so as to ensure that the shareholders in the general meeting receives an unbiased opinion on the true and fair view of the company's position. The function of an auditor has been succinctly described by Lord Oliver in *Caparo Industries plc v. Dickman & Ors* [1990] 1 All ER 568, 583, HL as:

> It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital) and, second, to provide shareholders with reliable intelligence for the purposes of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided.

[26] It is clear that in 2003 when IDSM purchased the electronic components from the plaintiff the directors of IDSM must have known that there was no reasonable prospect of the plaintiff ever receiving payment for the purchase price. By then IDSM was already down-sizing its operations. There was no reason for the directors to think that funds will become available to settle the purchase price. In 2003 manpower was being reduced and some of the assets of IDSM were disposed off. In 2004 practically all of IDSM's physical assets and stocks were written-off in the accounts and shipped to its holding company China Enersave Ltd in Singapore. Notwithstanding that IDSM had substantial trade receivables in excess of RM4 million, IDSM also decided to write-off the same as doubtful debts; when in fact the so-called doubtful

debt of RM3 million had been diverted to China Enersave Ltd. The actions aforesaid show that the management of IDSM did not act *bona fide* in the interest of the company as a whole; they did not act honestly. Instead they acted for a collateral purpose. IDSM was stripped of all its physical assets and its trade receivables. The ultimate beneficiary of these actions is China Enersave Ltd, the holding company. The actions are not consistent with current notions of fair trading. It is deceitful and unethical. It has been explicitly condemned by IDSM's own auditor. In the circumstances the court has no hesitation in finding that the business of IDSM appears to have been carried out with intent to defraud creditors within the meaning of s. 304(1).

Third Issue

[27] The third issue to be determined is whether any one of more of the defendants was knowingly a party to the carrying on of the business in that manner. The 1st, 2nd, 3rd and 4th defendants were directors of IDSM when the goods were purchased from the plaintiff in 2003. The 1st defendant resigned as director on 1 June 2004. Both the 1st and 2nd defendants said that all the decisions of IDSM were made by China Enersave Ltd. through its nominee directors the 3rd and 4th defendants. The 3rd and 4th defendants signed the 2004 Audited Accounts thereby asserting that it has been drawn up in accordance with approved accounting standards so as to give a true and fair view of the state of affairs of IDSM; the 4th defendant also signed a statutory declaration declaring himself as the director primarily responsible for the accounting records and financial management of IDSM and that the 2004 Audited Accounts are to the best of his knowledge and belief true and correct. Both the 1st and 2nd defendants denied any knowledge of the removal of IDSM's physical assets and stocks to China Enersave Ltd for zero consideration. Both the 1st and 2nd defendants were not involved in the Deed of Assignment of the trade receivables. The 1st and 2nd defendants were not party to the carrying on of the business in the manner. It is clear that throughout the period in question the management of IDSM was in the control of the 3rd and 4th defendants. The 'Statement By Directors' made by the 3rd and 4th defendants in the 2004 Audited Accounts and the Statutory Declaration by the 4th defendant as the director primarily responsible for the accounting records and financial management of

IDSM point directly to their role in carrying out the business of IDSM. The ultimate beneficiary of the transfer of the trade receivables and physical assets and stocks is China Enersave Ltd. The entire business was managed and controlled by the 3rd and 4th defendants *qua* directors of IDSM. They acted knowingly in the service of China Enersave Ltd. They were nominated to be directors of IDSM by China Enersave Ltd to safeguard China Enersave Ltd's interests.

[28] For the foregoing reasons the court makes the following orders:

(1) The claim against the 1st and 2nd defendant is dismissed with costs.

(2) A declaration that the 3rd and 4th defendants as directors of the 5th defendant are personally responsible, jointly and severally, to the plaintiff for the judgment debt of US$90,858.01 (or the equivalent in Ringgit Malaysia on the date of the order hereof) due and owing by the 5th defendant to the plaintiff;

(3) The 3rd and 4th defendants are, jointly and severally, to forthwith pay to the plaintiff the judgment debt of US$90,858.01 (or the equivalent in Ringgit Malaysia on the date of the order hereof) due and owing by the 5th defendant to the plaintiff;

(4) The 3rd and 4th defendants are, jointly and severally, to forthwith pay to the plaintiff interest on the judgment debt of US$90,858.01 at the rate of 8% per annum calculated from 16 February 2004 until full satisfaction of the judgment debt;

(5) Costs to be paid by the 3rd and 4th defendants.

(6) The security for costs provided by the plaintiff is to be released to the plaintiff.